IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION [LODGING] NO. 2516 OF 2004

1. Snowcem India Ltd.,]
   a company incorporated under]
   the Companies Act, 1956 /]
   Indian Companies Act, 1913,]
   having its registered office at]
   Killick Estate, Baji Pasalkar Marg,]
   Chandivli, Mumbai 400 072]

2. Ramesh Jagmohandas Paymaster,]
   of Mumbai Indian Inhabitant,]
   residing at LNHO,]
   Estate Building No.5,]
   7 K.M. Munshi Marg,]
   Mumbai 400 007]

3. Tejkumar Balkrishna Ruia,]
   of Mumbai, Indian Inhabitant,]
   residing at Samudra Gaurav]
   Apartment, 6A Worli Sea Face,]
   Mumbai 400 025]

4. Darsh Tejkumar Ruia,]
   of Mumbai, Indian Inhabitant,]
   residing at Samudra Gaurav]
   Apartment, 6A Worli Sea Face,]
   Mumbai 400 025] Petitioners

VERSUS

1. Union of India,]
   Aay Kar Bhavan, M.K. Marg,]
   Mumbai 400 020]

2. The Regional Director,]
   Company Law Administration,]
   Western Region, having his]
   office at Everest Building,]
   Marine Lines, Mumbai 400 002]

3. The Registrar of Companies,]
   Maharashtra, having his office]
   at Hakoba Compound,]
   2nd Floor, Dattaram Lad Marg,]
   Chinchpokli East Mumbai 400 033]

4. The Secretary,]
   Department of Company Affairs,]
   Government of India, having his]
   office at Shastri Bhavan,]
   New Delhi 110001.]

5. Peter Joseph Cook,]
   British National, residing at]
   2 Hawthrone Close,]
   Bickley Bromely, Kent BR]
   HJ, England]

6. Michael David Simmons,]
   British National, residing at]
   28 Wood Lang, London N6 SUB,]
   England]

7. Dr. Manfred Krauth,]
   German National, residing at]
   IN der]
   Hohl 20, 64367 MUHLTAL,]
   Germany.] ...Respondents.

Mr. Satish Shah with Mr. Anil D'Souza for the Petitioners

Mr. B.A. Desai, Additional Solicitor-General, with

Mr. S.S. Pakale and Mr.R.C. Master for Respondent Nos. 1 to 4.

CORAM: DALVEER BHANDARI,C.J. &
DR. D.Y. CHANDRACHUD,J.

DATE: 24TH SEPTEMBER, 2004

JUDGMENT (PER DALVEER BHANDARI, C.J.):-

1. The petitioners have challenged the constitutional validity of Section 274(1)(g) of the Companies Act, 1956 as amended with effect from 13th December, 2000 by the Companies (Amendment) Act, 2000. The petitioners pray that Section 274(1)(g) be declared illegal, invalid, null, void and unenforceable.

2. Brief facts necessary to dispose of this petition are recapitulated as under:-

The first petitioner is engaged in the manufacture and sale, *inter alia*, of cement based paints, brazing paste and plastic emulsion paints. The first petitioner was a profit-making company till 2000-2001. It is incorporated in the petition that the petitioners have started facing a serious shortage of working capital and they were compelled to borrow monies from banks and financial institutions. It is further incorporated that at present, there are a total of 1085 Fixed Deposits outstanding for repayment, totaling Rs.2.63 crores. It is stated that for deposits up to Rs.25,000/-, the petitioners had repaid two-third of the principal amount and the entire outstanding interest. It is also incorporated that that the petitioners have faced financial difficulties because of non-receipt of Rs.134 crores from its foreign buyers. It is stated that the petitioners are likely to make further repayments of mature fixed deposits in the near future.

3. The petitioners state that Section 274 of the Companies Act, 1956 provides grounds on which a Director is disqualified from being appointed. New clause (g) was added to sub-section (1) of Section 274 by the Companies (Amendment) Act, 2000 with effect from 13th December, 2000. Section 274 reads as under:-

"(1) A person shall not be capable of being appointed director of a company, if—

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of

six years has not elapsed from the date of expiry of the sentence;

(e) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call; or

(f) an order disqualifying him for appointment as director has been passed by a Court in pursuance of section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section;

(g) such person is already a director of a public company which—

(A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or

(B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Provided *that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause (a) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).*

(2) The Central Government may by notification in the official gazette, remove—

(a) the disqualification incurred by any person in virtue of clause (d) of sub-section (1), either

generally or in relation to any company or companies specified in the notification; or

(b) the disqualification incurred by any person in virtue of clause (e) of sub-section (1).

(3) A private company which is not a subsidiary of a public company may, by its articles, provide that a person shall be disqualified for appointment as a director on any grounds in addition to those specified in sub-section (1)."

4. According to the newly amended Act, a person shall not be capable of being appointed Director of a company, if such person is already a director of a public company which has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or has failed to repay its deposit or interest thereon on

due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

"Provided *that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause (a) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B)".*

5. The petitioners are aggrieved by the said newly added amendment and have prayed that the provisions of Sections 274 (1) (g) of the Companies Act, 1956 are *ultra vires* the Constitution and be declared illegal, invalid, null, void and unenforceable. The petitioners have also prayed that it be declared that the Companies (Disqualification of Directors under Section 274(1)(g) of

the Companies Act, 1956) Rules, 2003 are also *ultra vires* the rule-making power of the Central Government and consequently, are, therefore, null and void.

6. The petitioners have also prayed that this Court be pleased to issue writ of mandamus directing the 1st and 4th respondents to withdraw and cancel the impugned circular No. 8 dated 22nd March, 2002 and impugned circular No. 5 of 2003 dated 14th January, 2003. The petitioners have also prayed that the 1st to 4th respondents, their officers, servants and agents be restrained by an injunction from declaring that the 1st petitioner is a defaulter under Section 274(1)(g) of the Companies Act, 1956 and declaring that the 2nd to 4th petitioners or 5th to 7th respondents have or any of them has incurred any disqualification under Section 274(1)(g) of the Companies Act, 1956.

7. In the Statement of Objects and Reasons, it is enumerated that the above amendment will ensure proper governance of companies, transparency in working of companies and also ensure more effective enforcement. The impugned Section 274(1)(g) has been enacted with the intention and purpose of:-

(i) disqualifying errant Directors

(ii) Protecting the investors from mismanagement

(iii) ensuring compliance and filing of annual accounts and annual returns which are the means of disclosure to all stakeholders

(iv) increasing compliance rate of filing statutory documents, and

(v) infusing good corporate governance in the regulation of corporate affairs.

8. According to the petitioners, Section 274(1)(g), being highly arbitrary, unreasonable and unintelligible,

therefore, violative of Article 14 of the Constitution and would also be violative of the 2nd, 3rd and 4th petitioners' Fundamental Rights guaranteed under Articles 19(1)(g) and 21 of the Constitution.

9. It is further incorporated that the irrationality and complete arbitrariness in the enactment of Section 274(1)(g) is further demonstrated by virtue of the fact that Section 274(1)(g)(B) talks about debarring a person from being appointed as Director of any other public company, if he is a Director of a Public Company, which fails to repay deposits or interest thereon on the due date; to redeem debenture on due date; or pay dividend and such failure continues for one year or more. It is also incorporated in the petition that insofar as the failure to repay deposits or interest due or the failure to redeem debentures on the due date is concerned, the impugned provision does not make any distinction whatsoever

between a willful failure and a failure which is beyond the means or capacity of the company.

10. It is also submitted that as far as failure to pay dividend is concerned, the same cannot be clubbed along with the failure to pay deposit or interest thereon or failure to redeem debenture on due date, inasmuch as the obligation of the company to pay dividend arises only when the same is declared.

11. It is further submitted by the petitioners that where the failure to repay deposit or interest thereon or repay debenture arises out of the incapacity or inability of the company to do so, it would be highly arbitrary, unreasonable, harsh and burdensome to penalize the directors of such public limited companies and visit them with the penalty of disqualification not only of that company but also of all other public limited companies for a period of five years.

12. It is clear that this amendment has been carried out in case of a public company, which does not file annual accounts and annual returns for any continuous three financial years, and the director of such company will be debarred from becoming a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend.

13. We have heard the learned counsel for the parties at some length regarding validity and legality of the said amendment. In view of the Statement of Objects and Reasons of enactment of Section 274(1)(g) of the Act, it is abundantly clear that this amendment has been incorporated for better corporate governance and protection of the investment of the depositors. In the

instant case, the Company has collected huge deposits from small and poor investors, who had deposited their life-time savings with this Company, in the hope of getting reasonable interest on their deposits. It is expected that such amendment would ensure transparency in the functioning of the Company and would lead to the protection of the investment of investors and better corporate governance. According to the wisdom of the Legislature, this can be achieved by enhancing penalty /punishment for contravention so as to ensure better compliance of the provisions of the Companies Act, 1956.

14. We fail to appreciate how Article 21 of the Constitution is attracted, which refers to Right to Live. The challenge seems to be totally without any merit. We would appreciate if the submission is made on behalf of the small investors, who had deposited their life-time savings with the petitioners and similar other companies where

these small investors do not receive either the principal or interest and consequently, their children may not be provided education and/or medical treatment affecting their families' Fundamental Rights guaranteed under Article 21 of the Constitution. Therefore, if at all there is violation of Article 21, it is the violation of Fundamental Right under Article 21 of the children and their parents.

15. Similarly, we are unable to comprehend how the amendment of Section 274(1)(g) violates the petitioners' Fundamental Rights guaranteed under Article 19(1)(g) of the Constitution. This amendment does not debar the petitioners from carrying on any business, trade or occupation, only that the persons have been rendered incapable of becoming Directors in other companies. Perhaps, this amendment became imperative in view of a large number of companies becoming defaulters. It is a matter of common knowledge that millions of small investors, who had deposited their life-time savings with

these companies, in order to get reasonable returns, have been totally ruined. In most cases, they neither receive the principal amount nor any interest. Number of such petitions are pending in various Courts of the country. We find no merit in the submission of the petitioners that this amendment, in any manner, violates the petitioners' Fundamental Rights guaranteed under Article 19(1)(g) of the Constitution.

16. We do not see any merit in the petitioners' submission that this amendment, in any manner, violates the rules of natural justice. Once the Company failed to repay the interest or the principal amount, there is nothing required, but surely, when this fact is not disputed by the Company, the challenge that this amendment being violative of rules of natural justice becomes hollow and without any merit.

17. The petitioners' submission is that no distinction is made between its failure and failure beyond the means of the Directors of the Company. It is pertinent to note that Section 274(1)(g) does not penalize the company; it is only the Directors that are rendered incapable of functioning as Directors for certain period. The amendment has been carried out primarily to ensure that Directors of the Company should discharge their obligation properly. They should be more vigilant and careful and ensure that investors do not lose their life-time savings.

18. This would also, to some extent, ensure that the Directors should not take loan and see that no loan, more than their liability to repay, is taken.

19. We see no force in the submission of the petitioners that the section does not make any discrimination between Director and Non-Director or Executive and Non-

Executive Director. Once any person becomes a Director, it is his primary duty to ensure that there is proper governance and investors' money is protected.

20. We find no merit in the submission of the petitioners that this amendment is violative of Article 14 of the Constitution. The provision of Section 274(1)(g) does not make distinction between Government-nominated Director and other Director. The Government of India, Ministry of Law, Justice and Company Affairs' letter dated 22nd March, 2003 has interpreted the composite effect of the *non-obstante* clause in the statute of public financial institutions like Industrial Development Bank of India, Life Insurance Corporation of India, Unit Trust of India, etc., and gave an opinion that the Directors appointed by these institutions cannot be disqualified as appointment as Directors is by virtue of Section 274(1)(g) and also directors appointed on the Boards of assisted Companies, etc.

21. Regarding the grievance of the petitioners that the name of the disqualified directors are given on the website, it is desirable for the public to know the names of some defaulting directors of the other companies, so that they would be wary of such persons who are directors of such companies. This can also be justified in the larger public interest.

22. The petitioners have placed reliance on judgment of the Calcutta High Court in Writ Petition No. 199 of 2003 in *Duncan Industries Ltd.* The Court passed ad-interim order because the Bondholders gave their consent for re-structuring of the repayment schedule and the Ministry of Finance also gave their approval for restructuring the repayment schedule and extended time to make payment to the Bondholders till 31st December, 2010. The facts of that case are not applicable to the facts of the present case.

23. It may be pertinent to mention that this Court in *Cricket Club of India v. Madhav L. Apte & Ors.,* [1975] 45 Comp Cas 574, by judgment dated 30th August, 1974, had upheld the provisions of Section 274(3) of the Companies Act, 1956.

24. In our considered opinion, this amendment of Section 274(1)(g) of the Companies Act, 1956 has been made primarily in larger public interest. This amendment became absolutely imperative to protect large number of investors, particularly small and poor investors, who had invested their life-time savings with these companies, and in majority of cases, neither the principal amount nor interest is repaid. We find no merit in any of the submissions of the petitioners. We do not find that the said amendment violates the petitioners' Fundamental Rights or any other right in any manner.

25. The petition, being wholly devoid of merit, is accordingly dismissed.

CHIEF JUSTICE

DR. D.Y. CHANDRACHUD, J.